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INFO RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEHRC/DEPT OF AGRICULTURE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
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RUEKJCS/SECDEF WASHINGTON DC
RUEHBUL/AMEMBASSY KABUL 8868
RUEHDO/AMEMBASSY DOHA 1576
RUEHNE/AMEMBASSY NEW DELHI 3526
RUEHKP/AMCONSUL KARACHI 0031
RUEHLH/AMCONSUL LAHORE 5774
RUEHPW/AMCONSUL PESHAWAR 4553

UNCLAS SECTION 01 OF 02 ISLAMABAD 002428

SENSITIVE
SIPDIS

E.O. 12958: N/A
TAGS: EFIN ECON PREL PK
SUBJECT: State Bank of Pakistan acts to stop rupee slide

Summary
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¶1. (SBU) Summary: The State Bank of Pakistan (SBP) took measures on July 8 to stop the Pakistan rupee from further decreases against the U.S. dollar. The rupee has lost 16.8 percent of its value against the dollar since the beginning of 2008. The State Bank of Pakistan will now make 100 percent of oil import payments, and has suspended afternoon sessions for all types of foreign exchange transactions by banks with their customers and in the inter-bank market. The SBP has also reduced advance payments against imports. The State Bank maintains that these are only short term measures, and will not interfere with the liberalization of the foreign exchange regime. They are also not intended to restrict the repatriation of dividends, profits and royalties by multinationals or foreign companies. The SBP still sees no evidence of capital flight. End summary.

Measures to stem the rupee's fall
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¶2. (SBU) The State Bank of Pakistan took a number of measures July 8 to stem the rupee's increasingly sharp slide against the U.S. dollar. The rupee slid 2.6 percent on July 8 against the U.S. dollar, and closed at an all-time low at 72.85/90. It fell to 73.85 against the dollar on July 8 in futures trading. The rupee recovered a bit and stood at 70.99 versus dollar on July 17. Since January 2008, the rupee depreciated close to 17 percent against the dollar. Traders attributed the rupee fall to foreign exchange shortages due to forward buying, increasing oil prices requiring additional foreign exchange, and decreased foreign exchange inflows.

Reducing advance payments on imports
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¶3. (SBU) The SBP has reduced advance payments against imports to 25 per cent from 50 per cent. Importers were previously allowed to buy dollars in advance for up to 50 percent of the goods' import value. The SBP now permits advance foreign exchange purchases to cover only 25 percent of the FOB (Freight on Board) or CFR (Cost and Freight) value of the imported goods. However, the SBP is permitting dealers to honor previous commitments. The SBP has taken these measures after continuous depreciation of rupee in the inter-bank as well as open market. Through an amendment of the Exchange Companies Rules and Regulations, the SBP has further strengthened its monitoring

mechanism for transactions made through exchange companies to stem the decline in foreign exchange availability and any possible capital flight.

SBP to provide foreign exchange for oil imports
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¶4. (SBU) The central bank will now provide foreign exchange to banks for the import of all categories of oil to reduce the shortages that the increased price of petroleum had caused in the inter-bank market. SBP officials told Econoff that the SBP was making 100 percent of oil import payments prior to July 2007, but had shifted 20 percent of these payments to the inter-bank market after July ¶2007. Once again the SBP has taken over to make full oil import payments due to supply pressure on the inter-bank market.

Trading hours curtailed
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¶5. (SBU) The SBP has also reduced the time for all types of foreign exchange transactions by banks with their customers and in the inter-bank market until 2:00 pm Monday through Thursday and until 1:00 pm Friday and Saturday. Banks are, however, allowed to do foreign exchange swap transactions in the inter-bank market until 4:30 pm Monday through Friday and until 1:00 pm on Saturday.

Prior approval for transactions over USD 50,000
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¶6. (SBU) In addition, prior State Bank approval for all transactions

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USD 50,000 or more (or the equivalent in other foreign currencies) to individuals is now necessary. However, this requirement will not be applicable to sale of foreign currency to banks and other exchange companies. The central bank has advised exchange companies to forward requests to SBP with details of the transaction including the customer's name, address, national identity card number, amount and purpose of the transaction. Comment: This measure will also assist in anti-money laundering and terrorism financing efforts. End comment.

SBP says new measures are temporary
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¶7. (SBU) State Bank of Pakistan Foreign Exchange Department officials told Econoff that these are short term measures designed to control the rupee slide. They said that the rupee was depreciating rapidly and has depreciated close to 17 percent since January 2008, attributing the decline to political instability. They observed that these measures will not impact or reverse the liberalization of the foreign exchange regime because spot transactions in the are still permitted. Only the forward cover payments, which were designed to lock in the exchange rate have been suspended and advance payments against letters of credit for import have been reduced to 25 percent from 50 percent. They rejected the argument that the bank's measures will have a negative impact on importers.

Company remittances not affected
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¶8. (SBU) The SBP maintains that remittances of profits and royalties by multinational companies will not be affected since the SBP does not require approval for foreign exchange to repatriate dividends, profits or royalties. Only the exchange companies now require prior SBP approval for individuals who wish to send $50,000 or more overseas. The SBP pointed out that multinationals usually remit their money through banks, while individuals buy foreign exchange from exchange companies for overseas travel or other needs.

Comment
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¶9. (SBU) Comment: Despite the State Bank's claim that the fall in

the rupee is due to continuing political uncertainty in Pakistan, there are significant structural problems driving its precipitous decline over the past few weeks. The rupee cannot stabilize or maintain its current value unless structural imbalances such as the large import-export gap and the current account deficit are brought under control. The rupee has decreased 16.8 percent since the beginning of the year.

¶10. (SBU) Comment continued: While there is no evidence of capital flight according to SBP sources, most portfolio investment has left, and foreign exchange inflows have slowed down significantly. Repatriation of profits and royalties rose by 11.9 percent between July 2007 and May 2008, resulting in a USD 847 million outflow. However, we do not see this increase as particularly significant, given the amount of foreign investment in Pakistan, its concentration in the profitable banking and telecoms sectors, and the fact that most companies had an extremely profitable 2007. As a result of the decreased foreign inflows and increased oil prices, a sizable gap between demand and supply now exists in the foreign exchange market, resulting in the rapid depreciation of rupee. The SBP will now make 100 percent payments for oil imports, which will further drain its foreign exchange reserves, thus putting additional pressure on the beleaguered rupee. End comment.

PATTERSON